

Statement by the Honorable Frank Carlucci
Chairman of the Board
Nortel Networks

Before the
U.S. Senate Foreign Relations Committee
on
International Economic Policy, Export and Trade Promotion
and
East Asian and Pacific Affairs

April 6, 2000

Mr. Chairman, and distinguished Members of the Committee. Thank you for inviting me here today to present the high-tech industry perspective. I am here today in my capacity as Chairman of the Board of Nortel Networks. I am also Chairman of the Board of the Carlyle Group. From 1987 to 1989, I was the Secretary of Defense and previously served as President Reagan's National Security Advisor in 1987 and was intimately involved with the shaping of the U.S.' unique and often complicated relations with foreign nations, including China.

You invited me to speak today about granting permanent normal trade relations to China--the most contentious trade debate to hit Congress in the last two decades.

Nortel Networks is one of the world's largest suppliers of digital network solutions. It is the most broadly diversified developer of high capacity switching and optics technology. We are at the heart of the Internet. Over 75 percent of all Internet traffic in North America and more than half in Europe travels over Nortel Networks' backbone. We have a presence in over 150 countries where we work with customers to build and deliver communications and IP (Internet Protocol)--optimized products and networks or what we call "Unified Networks." No other company in the world can deliver global applications and services that merge new and existing networking elements and technologies into a seamless open network. We have over 35,000 employees in the U.S. out of 75,000 globally.

NORTEL NETWORKS: A LONG HISTORY IN CHINA

In China, we employ approximately 2,000 citizens and pay some of the highest wages in China. While Nortel Networks China was officially launched in 1993, our first sale there dates back to 1972. Our business operations include R&D, manufacturing, sales and service in the People's Republic of China, Hong Kong and Taiwan. We participate in four joint ventures in China and partner with the Beijing University of Posts and Telecommunications in the operation of one of Nortel Networks' global R & D centers.

This long history of doing business in China has given us a strong understanding of the obstacles foreign companies must navigate to succeed in China's marketplace. Our most recent win--providing China's second largest telecommunications carrier with product solutions that will bring a new, high-performance Internet to thousands of users--is one of many we have had over the years. So it has been worth the effort.

We witnessed the slow but meaningful reforms that have taken place in China over the past twenty years. These Nortel Networks experiences and my own dealings with China have led me to conclude that the United States must support PNTR and membership in the WTO for China. I firmly believe that bringing China into the global rules-based system will bring positive economic change, protect our national security interests and lead to social reforms that benefit Chinese citizens

WITHOUT PNTR, THE U.S. ECONOMY LOSES

Current Chinese law requires the intimate involvement of a Chinese middleman in every import or export activity conducted by American and other foreign companies. This severely limits our ability to engage with and export to China, particularly now when high-tech companies must act at webspeed. As negotiated in the U.S.-China WTO accession agreement, China will phase out the mandatory middleman practice over a three-year period beginning upon its accession.

While I am certain you have already heard the arguments from industry about the critical need to grant China PNTR, I believe a few warrant repeating because they illustrate how profoundly WTO accession will impact American industry's ability to do business in China:

- While the agreement does not require concessions from the U.S., China must make deep and fundamental reforms that reach the core of every aspect of its economy. I learned on my trip to China last week that they understand this and accept it. They are most anxious to enter the new economy and will pay the price.
- Unilateral concessions will eliminate barriers prohibiting the free export of U.S. goods and services in virtually every industry sector.
- The U.S. will gain unprecedented access to a market of more than one billion people.
- And China's accession will provide the U.S. with stronger protection against China's unfair trade practices through a safeguard that provides penalties against damaging import surges.

Considering its immediate and potential impact on the American economy, supporting China's WTO membership should be a top priority. According to the Institute for International Economics' conservative estimates, passage of China's WTO entry will result in an immediate increase in U.S. exports of \$3.1 billion. While we cannot ignore the fact that U.S. exports to China have grown throughout the past

twenty years from nothing to over \$14 billion annually, China's WTO accession is the best cure for the U.S.--China trade deficit.

According to Commerce Department figures, the U.S. imported a tremendous \$71.2 billion from China in 1998 but exported a meager \$14.3 billion in the same year. That's a 5:1 ratio--in China's favor.

With the WTO agreement, that ratio will shrink.

A vote against PNTR for China will prevent this from happening. If we deny China PNTR, WTO rules allow China the right to legally prohibit U.S. access to the very benefits Republican and Democratic Administrations have worked to achieve for over thirteen years. Under this scenario, the U.S. economy--not the Chinese--will suffer the consequences.

CHINA'S HIGH-TECH INDUSTRY: A GOLDEN OPPORTUNITY

Nortel Networks and the U.S. high-tech industry stand to gain tremendously from China's accession to the WTO. China is the world's fastest growing telecom market. In fact, its cellular market is expected to be second only to the U.S. by the end of this year. China's telecommunications equipment market, valued at \$19 billion last year, is anticipated to grow 20-40 percent annually. Internet subscribers in China have more than quadrupled and are expected to reach an astounding 20 million by the end of the year. At present, China's state-owned enterprises represent the majority of business in China, but Congress holds the key to unlocking that market and opening it up to American business.

- Permanent normal trade relations with China will allow U.S. high-tech businesses unprecedented access to Chinese markets. By 2005, our products will no longer be subject to tariffs averaging 13 percent and, immediately upon accession, China will remove burdensome import quotas.

China will no longer impose technology transfer requirements and we will, as a result, have greater protection for our proprietary products. Those changes will allow the high-tech industry to:

- Export products directly from the U.S. rather than being forced to set up manufacturing facilities in China. This means increased jobs in the U.S.
- Enjoy national treatment and no longer be faced with anti-competitive "buy China" requirements.
- And, one of the greatest breakthroughs--China has agreed to sign onto the WTO Basic Telecommunications Agreement. With this signature, the U.S. high-tech industry will finally gain access to China's public telecom network that will be regulated by an independent regulatory authority. Increased competition means increased business for us.

It is no secret that America's information technology industry is the catalyst for the tremendous economic growth the U.S. is witnessing. We are the largest manufacturing sector in the U.S. and we have fueled 44 percent of our domestic economic growth since 1994. Our employees have profited from our success. IT workers earn an average of 77 percent more than the average American worker.

We have created positive and unparalleled change here at home and we should not be denied the opportunity to do the same in China.

WTO MEMBERSHIP WILL BE A POSITIVE FORCE OF CHANGE IN CHINA

WTO membership will be a powerful, positive and legally mandated force for dramatic change in China. Since the U.S. re-engaged with China over twenty years ago, U.S. companies have improved wages and working conditions in China by providing high-paying jobs and promoting entrepreneurship in a manner state-owned enterprises never viewed as necessary.

In November, Chinese negotiators agreed for the first time to allow American companies to play a central role in building China's information infrastructure. By making this concession, China has committed to an open Internet environment that allows its citizens more communication with each other and increased access to the world beyond China's border. This moves China closer to a concept I have promoted throughout my career--communication is the best mechanism for generating tangible change in a country that has a history of repressing free speech.

Building bridges of communication always forges social, political and economic reforms.

The changes will be felt in other areas as well. The business climate in China will go through a renaissance.

China's concessions will bring an unprecedented level of competition in China. Most significantly, China's state-owned enterprises will compete on commercial terms. As it has done in all market-oriented economies, increased foreign competition and investment will foster lower prices and technological innovation, and will contribute to significant increases in wages and living standards.

CONCLUSION: ENGAGEMENT IS OUR BEST LINE OF DEFENSE IN CHINA

Three years ago, ten former Secretaries of Defense, including myself, sent this letter [Mr. Carlucci will hold up a copy of the letter] to President Clinton reaffirming our view that renewing most favored nation trading status for China will promote the U.S.' national security interests. In that letter, we recognized that while there are "several thorny and disturbing issues in the complicated [bilateral] relationship, ...the most promising way to reach the goal of a stable China is for the U.S. to continue to build a relationship of mutual engagement with China." That statement is truer today than ever before.

Our two countries have had their differences and we will continue to differ. Engagement, however, has enabled us to pursue our national security interests by building relationships between our militaries and governments. Regular meetings over the years have increased our understanding of one another's military strategies, cultures and politics.

Congress has voted in favor of engagement with China for twenty years. This year, we have the opportunity give industry a more predictable climate in which to operate, and assuage industry concern's that Congress will pull the plug on our bilateral relationship. Denying PNTR for China will irreversibly damage our often times fragile relationship with our fourth largest trading partner.

China will interpret our denial of PNTR as the adoption of a policy of confrontation and will exercise its legal right under the WTO to bar U.S. companies from reaping the benefits of its WTO accession. In turn, the presence of U.S. companies in China will stagnate and we will be unable to compete against our competitors who enjoy the benefits of China's WTO accession. A policy of engagement with China is our best line of defense against this grave consequence.

I strongly believe that PNTR and China's WTO accession will help the Chinese people gain increased access to communications tools like the Internet. These tools cannot be controlled and they will help connect the Chinese people to the rest of the world like never before. If the U.S. is to play any kind of role in this transformation, we must grant PNTR for China.

Granting PNTR to China will guarantee U.S. companies access to China **on our terms**; denying PNTR will place the terms of our access **in China's hands**.

Congress must decide which alternative to choose. From an economic and business perspective, it's an open and shut case. We hope you make the right decision.

Thank you for inviting me to appear before you. I would be pleased to answer your questions.

###